

(3) If the amount of gain described in subparagraph (1) of this paragraph allocable to a mineral property for a taxable year exceeds the allowable deductions otherwise taken into account in computing the taxable income from the mineral property for the taxable year, the excess may not be taken into account in computing the taxable income from the mineral property for any other taxable year.

(4) To the extent that the adjustments reflected in the adjusted basis of the section 1245 property are allocable to mineral property which the taxpayer no longer owns in the taxable year in which he disposes of the section 1245 property, the gain recognized under section 1245(a)(1) does not result in any tax benefit to the taxpayer under this paragraph since he has no taxable income from the mineral property for such year. However, if a taxpayer has, in the taxable year in which he disposes of an item of section 1245 property, only a portion of the original mineral property to which gain described in subparagraph (1) of this paragraph with respect to the section 1245 property is properly allocable, the entire amount of that gain shall nevertheless be taken into account in computing the taxable income of the remaining portion of the mineral property. Furthermore, the fact that a mineral property to which section 1245 gain is properly allocable is (in the taxable year in which the taxpayer disposes of an item of section 1245 property) no longer in existence merely because the mineral property has been made a part of an aggregation or has been deaggregated will not result in the loss of tax benefits under this section. Accordingly,

(i) If a taxpayer has made an aggregation of mineral properties (see section 614 and the regulations thereunder), the amount of any gain described in subparagraph (1) of this paragraph which is properly allocable to the aggregation shall include the portion of any gain which would be properly allocable to the mineral properties which existed separately prior to the aggregation and of which the aggregation is or was composed, if the prior mineral properties had not been aggregated; and

(ii) If a taxpayer has deaggregated a mineral property, the amount of any gain described in subparagraph (1) of this paragraph which is properly allocable to each of the resulting mineral properties shall include a part of the portion of any gain which would be properly allocable to the prior aggregation if the aggregation had not been deaggregated, the part properly allocable to each of the resulting properties being determined by allocating the gain between the resulting properties in the same manner as basis is allocated between them for tax purposes (see paragraph (a)(2) of § 1.614-6 and example 5 of subparagraph (7) of this paragraph).

(5) In any case in which it is necessary to determine the portion of any gain recognized under section 1245(a)(1) which is properly allocable to the mineral property in respect of which the taxable income is being computed, the taxpayer shall have available permanent records of all the facts necessary to determine with reasonable accuracy the amount of such portion. In the absence of such records, none of the gain recognized under section 1245(a)(1) shall be allocable to such mineral property.

(6) As used in this paragraph, the term *mineral property* has the meaning assigned to it by section 614 and § 1.614-1.

(7) The provisions of this paragraph may be illustrated by the following examples:

Example 1. A, who uses the calendar year as his taxable year, operated and treated as separate properties mines Nos. 1 and 2. On January 1, 1963, A acquired a truck which was section 1245 property. During 1963 and 1964 the truck was used 25 percent of the time at mine No. 1 and 75 percent of the time at mine No. 2. For each such year the depreciation adjustments allowed in respect of the truck were \$800 (the amount allowable). In computing the taxable income from mines Nos. 1 and 2 for each such year, \$200 (25 percent of \$800) of the depreciation adjustments was allocated by A to mine No. 1 and \$600 (75 percent of \$800) to mine No. 2. Thus, for the 2 years, the total of the depreciation adjustments on the truck was \$1,600, of which \$400 was allocated to mine No. 1 and \$1,200 to mine No. 2. On January 1, 1965, A recognized upon sale of the truck a gain of \$500 to which section 1245(a)(1) applied. During 1965, A did not recognize any other gain to which section 1245(a)(1) applied. In computing taxable

income from the mines for 1965, the expenses otherwise required to be taken into account are reduced by \$125 (that is \$400/\$1,600 of \$500) for mine No. 1 and by \$375 (that is \$1,200/\$1,600 of \$500) for mine No. 2.

Example 2. The situation is the same as in example 1, except that the truck in question is used 25 percent of the time at mine No. 1, and 75 percent of the time in a nonmining business owned by A. Accordingly, in computing taxable income from A's mines for 1965, the expenses for mine No. 1 otherwise required to be taken into account are reduced by \$125 (that is \$400/\$1,600 of \$500), but no reduction is made in the expenses for mine No. 2, since the truck in question was not used in connection with that mineral property.

Example 3. The situation is the same as in example 1, except that the truck in question was used exclusively at mine No. 1 in 1963. On January 1, 1964, the truck was transferred to mine No. 2, and was used exclusively at mine No. 2 during the remaining period prior to its sale. However, A continued to own and operate mine No. 1. For the 2 years 1963 and 1964, the total of the depreciation adjustments on the truck was \$1,600, of which \$800 was allocated to mine No. 1 and \$800 to mine No. 2. In computing taxable income from A's mines for 1965, the expenses for mines Nos. 1 and 2 otherwise required to be taken into account are reduced by \$250 each (that is \$800/\$1,600 of \$500). If A had sold mine No. 1 on January 1, 1964, no reduction in expenses would be allowable as a result of the operation of the truck at mine No. 1, since A would no longer have owned mine No. 1 in the year in which the truck was sold.

Example 4. On January 1, 1963, B, who uses the calendar year as his taxable year and who normally allocates depreciation costs to mines according to the percentage of time which the depreciable asset is used with respect to the mines, acquired a truck which was section 1245 property. During 1963 the truck was used exclusively on mine No. 1, which B operated and treated as a separate property. The depreciation adjustments allowed in respect of the truck for 1963 were \$1,000 (the amount allowable), which amount was allocated to mine No. 1 in computing the taxable income therefrom. On January 1, 1964, B acquired and began operating mine No. 2 and elected under section 614(c) to aggregate and treat as one property mines Nos. 1 and 2. During 1964 B used the truck 60 percent of the time for mine No. 1 and 40 percent of the time for mine No. 2. For 1964 the depreciation adjustments allowed in respect of the truck were \$1,000 (the amount allowable), which amount was allocated to the aggregation of mines Nos. 1 and 2 in computing the taxable income therefrom. On December 31, 1964, B sold mine No. 2. For 1965 the depreciation adjustments allowed in respect to the truck were \$1,000 (the amount allowable),

which amount was allocated to mine No. 1 in computing the taxable income therefrom. On January 1, 1966, B recognized gain upon sale of the truck of \$600 to which section 1245(a)(1) applied. In computing the taxable income from mine No. 1 for 1966, the expenses otherwise required to be taken into account are reduced by \$600, since all the depreciation adjustments allowed with respect to the truck, including those allowed with respect to the use of the truck at mine No. 2 (\$400 for 1964), relate to the same mineral property from which B had taxable income in 1966, the taxable year in which he sold the truck.

Example 5. On January 1, 1962, A, who uses the calendar year as his taxable year, elected under section 614(c) to aggregate and treat as one mineral property his operating mineral interests in mines Nos. 1 and 2. On January 1, 1963, A acquired a truck which was section 1245 property, to be used at both mine No. 1 and mine No. 2. A later elected (with the consent of the Commissioner) to deaggregate mines Nos. 1 and 2, and this deaggregation became effective on January 1, 1964. At the time of deaggregation, half of the tax basis of the aggregated property was allocated to mine No. 1, and the other half to mine No. 2. During each of the years 1963 and 1964, the truck was used 25 percent of the time on mine No. 1 and 75 percent of the time on mine No. 2, and the depreciation adjustments allowed in respect of the truck were \$800 (the amount allowable). On January 1, 1965, A recognized upon sale of the truck a gain of \$500 to which section 1245(a)(1) applied. In computing taxable income from A's mines for 1965, the expenses otherwise required to be taken into account are reduced by \$187.50 (that is half of \$250 for 1963 and \$200/\$800 of \$250 for 1964) for mine No. 1 and by \$312.50 (that is half of \$250 for 1963 and \$600/\$800 of \$250 for 1964) for mine No. 2.

(c) *Treatment of particular items in computing taxable income from the property.* In determining taxable income from the property under the provisions of paragraph (a) of this section:

(1) Trade or cash discounts (or allowances determined to have the same effect as trade or cash discounts) which are actually allowed to the taxpayer in connection with the acquisition of property, supplies, or services shall not be included in the cost of such property, supplies, or services.

(2) Intangible drilling and development costs which are deducted under section 263(c) and § 1.612-4 shall be subtracted from the gross income from the property.

(3) Exploration and development expenditures which are deducted for the

taxable year under sections 615, 616, or 617 shall be subtracted from the gross income from the property.

(4)(i) Selling expenses, if any, paid or incurred with respect to a raw mineral product shall be subtracted from gross income from the property. See subdivision (iii) of this subparagraph for the definition of the term *raw mineral product*. For example, the selling expenses paid or incurred by a producer of raw mineral products with respect to products such as crude oil, raw gas, coal, iron ore, or crushed dolomite shall be subtracted from gross income from the property.

(ii) A reasonable portion of the expenses of selling a refined, manufactured, or fabricated product shall be subtracted from gross income from the property. Such reasonable portion shall be equivalent to the typical selling expenses which are incurred by unintegrated miners or producers in the same mineral industry so as to maintain equality in the tax treatment of unintegrated miners or producers in comparison with integrated miner-manufacturers or producer-manufacturers. If unintegrated miners or producers in the same mineral industry do not typically incur any selling expenses, then no portion of the expenses of selling a refined, manufactured, or fabricated product shall be subtracted from gross income from the property when determining the taxpayer's taxable income from the property.

(iii) For purposes of this subparagraph, a product will be considered to be a raw mineral product if (in the case of oil and gas) it is sold in the immediate vicinity of the well or if (in the case of minerals other than oil and gas) it is sold under the conditions described in paragraph (b)(1) of § 1.613-4. In addition, a product will be considered to be a raw mineral product if only insubstantial value is added to the product by nonmining processes (or, in the case of oil and gas, by conversion or transportation processes). For example, in the case of a producer of crushed granite poultry grit, both bulk and bagged grit will be deemed to be a raw mineral product for purposes of the selling expense rule set forth in this subparagraph.

(iv) The term *selling expenses*, for purposes of this subparagraph, includes sales management salaries, rent of sales offices, sales clerical expenses, salesmen's salaries, sales commissions and bonuses, advertising expenses, sales traveling expenses, and similar expenses, together with an allocable share of the costs of supporting services, but the term does not include delivery expenses.

(5) Taxes which are taken as a credit rather than as a deduction or which are capitalized shall not be subtracted from the gross income from the property.

(6) Trade association dues paid or incurred by a producer of crude oil or gas or a raw mineral product shall be subtracted from the gross income from the property. See subparagraph (4) (iii) of this paragraph for the definition of the term *raw mineral product*. In addition, a reasonable portion of the trade association dues incurred by a producer of a refined, manufactured, or fabricated product shall also be subtracted from gross income from the property if the activities of the association relate to production, treatment and marketing of the crude oil or gas or raw mineral product. One reasonable method of allocating the trade association dues described in the preceding sentence is an allocation based on the proportion that the direct costs of mining processes and the direct costs of nonmining processes (or in the case of oil and gas, conversion and transportation processes) bear to each other. The foregoing rules shall apply even though one of the principal purposes of an association is to advise, promote, or assist in the production, marketing, or sale of refined, manufactured, or fabricated products. For example, a reasonable portion of the trade association dues paid to an association which promotes the sale of cement, refined petroleum, or copper products shall be subtracted from gross income from the property.

[T.D. 6955, 33 FR 6968, May 9, 1968. Redesignated by T.D. 7170, 37 FR 5374, Mar. 15, 1972, as amended by T.D. 7170, 37 FR 5381, Mar. 15, 1972]

§ 1.613-6 Statement to be attached to return when depletion is claimed on percentage basis.

In addition to the requirements set forth in paragraph (g) of § 1.611-2, a taxpayer who claims the percentage depletion deduction under section 613 for any taxable year shall attach to his return for such year a statement setting forth in complete, summary form, with respect to each property for which such deduction is allowable, the following information:

(a) All data necessary for the determination of the *gross income from the property*, as defined in §§ 1.613-3 from 1.613-4, including:

(1) Amounts paid as rents or royalties including amounts which the recipient treats under section 631(c).

(2) Proportion and amount of bonus excluded, and

(3) Amounts paid to holders of other interests in the mineral deposit.

(b) All additional data necessary for the determination of the *taxable income from the property (computed without the allowance for depletion)*, as defined in § 1.613-5.

[T.D. 7170, 37 FR 5382, Mar. 15, 1972]

§ 1.613-7 Application of percentage depletion rates provided in section 613 (b) to certain taxable years ending in 1954.

(a) *Election of taxpayer.* In the case of any taxable year ending after December 31, 1953, to which the Internal Revenue Code of 1939 is applicable, the taxpayer may elect in accordance with section 613(d) and this section to apply the appropriate percentage depletion rate specified in section 613 in respect of any mineral property (within the meaning of the 1939 Code). In the case of mines, wells, or other natural deposits listed in section 613(b), the election may be made by the taxpayer irrespective of whether his depletion allowance with respect to the property for the taxable year was computed upon the basis of cost, discovery value, or upon a percentage of gross income from the property. Once made, the election shall be irrevocable with respect to the property for which it is exercised. The election may be made for any mineral property of the taxpayer and need not be made for all such properties. *Gross*

income from the property and *net income from the property* shall have the same meaning as those terms are used in 26 CFR (1939) 39.23(m)-1 (Regulations 118).

(b) *Computation of depletion allowance.* The depletion allowance for any taxable year with respect to any property for which the taxpayer makes the election under section 613(d) shall be an amount equal to the sum of:

(1) That portion of a tentative allowance, computed under the provisions of the Internal Revenue Code of 1939 (without regard to paragraph (1) of section 613(d)), which the number of days in the taxable year prior to January 1, 1954, bears to the total number of days in such taxable year; plus

(2) That portion of a tentative allowance, computed by using the appropriate percentage depletion rate specified in section 613(b) (but otherwise computed under the provisions of the Internal Revenue Code of 1939), which the number of days in the taxable year after December 31, 1953, bears to the total number of days in such taxable year.

In the case of any taxable year beginning after December 31, 1953, and ending before August 17, 1954, the depletion allowance with respect to any property for which the taxpayer makes the election under section 613(d) shall be computed under the provisions of the Internal Revenue Code of 1939, except that the appropriate percentage depletion rate specified in section 613(b) shall be used. In making such computation, *gross income from the property* and *net income from the property* shall be determined in the same manner as specified in paragraph (a) of this section.

(c) *Examples.* The provisions of this section may be illustrated by the following examples:

Example 1. A is a taxpayer who reports income on the basis of a taxable year ending June 30. For the taxable year ended June 30, 1954, A had gross income from a uranium property in the amount of \$100,000 and his depletion allowance was computed with reference to percentage depletion. His net income from this property, for purposes of limiting the depletion allowance, was \$40,000. The 15-percent rate of depletion provided for in the Internal Revenue Code of 1939 for

metal mines resulted in a depletion allowance for the taxable year of \$15,000. Percentage depletion computed with reference to the 23-percent rate provided for uranium under section 613(b) is \$23,000 (\$100,000 times 23 percent). However, the allowance computed on this basis is limited to \$20,000 (50 percent of A's net income from the property). If A exercises the election provided for in section 613(d) his depletion allowance for the taxable year is the aggregate of \$7,561.64 (184/365 times \$15,000) plus \$9,917.80 (181/365 times \$20,000) or \$17,479.44.

Example 2. Assume the same facts as in example 1 except that A's depletion allowance was computed on the basis of cost and amounted to \$17,500. If the election is made, A's allowance for the taxable year is the aggregate of \$8,821.92 (184/365 times \$17,500) plus \$9,917.80 (181/365 times \$20,000) or \$18,739.72.

(d) *Requirement for making election.* (1) The election under section 613(d) shall be made by filing a statement with the district director with whom the income tax return was filed for the taxable year to which the election is applicable. Such statement shall indicate that an election is being made under section 613(d), shall contain a recomputation of the depletion allowance and the tax liability for all taxable years affected by the exercise of the election, and shall be accompanied either by a claim for refund or credit or by an amended return or returns, whichever is appropriate.

(2) If the treatment of any item upon which a tax previously determined was based, or if the application of any provisions of the internal revenue laws with respect to such tax, depends upon the amount of income (e.g., charitable contributions, foreign tax credit, dividends received credit, and medical expenses), readjustment in these particulars will be necessary as part of any recomputation in conformity with the change in the amount of the income which results solely from the making of the election under section 613(d).

(e) *Administrative provisions; etc.* (1) Section 36(b) of the Technical Amendments Act of 1958 (72 Stat. 1633) provides as follows:

*Sec. 36. Percentage depletion rates for certain taxable years ending in 1954. * * **

(b) *Statute of limitations, etc.; interest.* If refund or credit of any overpayment resulting from the application of the amendment made by subsection (a) of this section is prevented on the date of the enactment of this Act, or

within 6 months from such date, by the operation of any law or rule of law (other than section 3760 of the Internal Revenue Code of 1939 or section 7121 of the Internal Revenue Code of 1954, relating to closing agreements, and other than section 3761 of the Internal Revenue Code of 1939 or section 7122 of the Internal Revenue Code of 1954, relating to compromises), refund or credit of such overpayment may, nevertheless, be made or allowed if claim therefor is filed within 6 months from such date. No interest shall be paid on any overpayment resulting from the application of the amendment made by subsection (a) of this section.

(2) If refund or credit of any overpayment resulting from the application of section 613(d) is prevented on September 2, 1958, or on or before March 2, 1959, by the operation of any law or rule of law (other than section 3760 of the Internal Revenue Code of 1939 or section 7121 of the Internal Revenue Code of 1954, relating to closing agreements, and other than section 3761 of the Internal Revenue Code of 1939 or section 7122 of the Internal Revenue Code of 1954, relating to compromises), refund or credit of such overpayment may, nevertheless, be made or allowed if claim therefor is filed on or before March 2, 1959. If such refund or credit is not prevented on or before March 2, 1959, the time for filing claim therefor shall be governed by the rules of law generally applicable to credits and refunds.

(3) The amount of any refund or credit which is allowable by reason of section 613(d) shall not exceed the decrease in income tax liability resulting solely from the application of the percentage rates specified in section 613(b). No interest shall be allowed or paid on any overpayment resulting from the application of section 613(d).

(4) For purposes of this section the *decrease in income tax liability* shall be the amount by which the tax previously determined (as defined in section 3801(d) of the Internal Revenue Code of 1939) exceeds the tax as recomputed under section 613(d) and this section.

(f) *Adjustment to basis.* Proper adjustment shall be made to the basis of any property as required by section 113(b)(1) of the Internal Revenue Code of 1939 and 26 CFR (1939) 39.113(b)(1)-1(c) (Regulations 118) to reflect any change

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in the depletion allowance resulting from the application of section 613(d) of the Internal Revenue Code of 1954.

[T.D. 6500, 25 FR 11737, Nov. 26, 1960. Redesignated by T.D. 7170, 37 FR 5374, Mar. 15, 1972]

§ 1.613A-0 Limitations on percentage depletion in the case of oil and gas wells; table of contents.

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[T.D. 8348, 56 FR 21938, May 13, 1991, as amended by T.D. 8437, 57 FR 43899, Sept. 23, 1992]

§ 1.613A-1 Post-1974 limitations on percentage depletion in case of oil and gas wells; general rule.

Except as otherwise provided in section 613A and the regulations thereunder, in the case of oil or gas which is produced after December 31, 1974, and to which gross income from the property is attributable after such year, the allowance for depletion under section 611 with respect to any oil or gas well shall be computed without regard to section 613. In the case of a taxable year beginning before January 1, 1975, and ending after that date, the percentage depletion allowance (but not the cost depletion allowance) with respect to oil and gas wells for such taxable year shall be determined by treating the portion thereof in 1974 as if it were a short taxable year for purposes of section 613 and the portion thereof in 1975 as if it were a short taxable year for purposes of section 613A.

[T.D. 7487, 42 FR 24264, May 13, 1977]

§ 1.613A-2 Exemption for certain domestic gas wells.

(a) The allowance for depletion under section 611 shall be computed in accordance with section 613 with respect to:

(1) Regulated natural gas (as defined in paragraph (c) of § 1.613A-7),

(2) Natural gas sold under a fixed contract (as defined in paragraph (d) of § 1.613A-7), and

(3) Any geothermal deposit in the United States or in a possession of the United States that is determined to be a gas well within the meaning of former section 613(b)(1)(A) (as in effect before enactment of the Tax Reduction Act of 1975) for taxable years ending after December 31, 1974, and before October 1, 1978 (see section 613(e) for depletion on geothermal deposits thereafter),

(b) For taxable years ending after September 30, 1978, the allowance for depletion under section 611 shall be computed in accordance with section 613 with respect to any qualified natural gas from geopressured brine (as de-

fined in paragraph (e) of § 1.613A-7), and 10 percent shall be deemed to be specified in section 613(b) for purposes of section 613(a).

(c) For special rules applicable to partnerships, S corporations, trusts, and estates, see paragraphs (e), (f), and (g) of § 1.613A-3.

(d) The provisions of this section may be illustrated by the following examples:

Example 1. A is a producer of natural gas which is sold by A under a contract in effect on February 1, 1975. The contract provides for an increase in the price of the gas sold under the contract to the highest price paid to a producer for natural gas in the area. The gas sold by A qualifies under section 613A(b)(1)(B) for percentage depletion as gas sold under a fixed contract until its price increases, but is presumed not to qualify thereafter unless A demonstrates by clear and convincing evidence that the price increase in no event takes increases in tax liabilities into account.

Example 2. B is a producer of natural gas which is sold by B under a contract in effect on February 1, 1975. The contract provides that beginning January 1, 1980, the price of the gas may be renegotiated. Such a provision does not disqualify gas from qualifying for the exemption under section 613A(b)(1)(B) with respect to the gas sold prior to January 1, 1980. However, gas sold on or after January 1, 1980, does not qualify for the exemption whether or not the price of the gas is renegotiated.

[T.D. 8348, 56 FR 21939, May 13, 1991, as amended by T.D. 8437, 57 FR 43899, Sept. 23, 1992; 58 FR 6678, Feb. 1, 1993]

§ 1.613A-3 Exemption for independent producers and royalty owners.

(a) *General rules.* (1) Except as provided in section 613A(d) and § 1.613A-4, the allowance for depletion under section 611 with respect to oil or gas which is produced after December 31, 1974, and to which gross income from the property is attributable after that date, shall be computed in accordance with section 613 with respect to:

(i) So much of the taxpayer's average daily production (as defined in paragraph (f) of § 1.613A-7) of domestic crude oil (as defined in paragraphs (a) and (g) of § 1.613A-7) as does not exceed the taxpayer's depletable oil quantity (as defined in paragraph (h) of § 1.613A-7), and